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To:

Cc:

Subject: RE: Reporting Interest

Hi

The analysis here should not be complicated. As I understand the facts, the employer is providing cash in lieu of the health benefits that it should have provided. Even though the health benefits themselves may have been excludable from gross income, the cash payments are not. These payments are regular wages reported on Form W-2. See the Adkins income tax case, which held that a similar settlement was includible in gross income and not excludable under section 106. *Adkins v. United States*, 882 F.2d 1078, 1081 (6th Cir.1989)

Lump-sum payments to taxpayers in settlement of lawsuits against former employer concerning employer's proposed termination of contributions to hospital-medical benefits plan did not fall within provisions of section which excludes contributions by employer to accident or health plans from gross income; statute did not provide exemption for payments made by employer directly to employees. 26 U.S.C.A. § 106.

Also, see following quotation from *LTV Steel Co., Inc. v. United States*, 215 F.3d 1275, 1280 (Fed Cir. 2000), an employment tax case which held that certain payments made under nonqualified plans were subject to FICA and FUTA taxes.

Simply put, a payment that is specifically made subject to taxation is not rendered exempt from tax simply because it is made in settlement of an obligation which, had it been paid, would not have been taxed. See *Adkins v. United States*, 882 F.2d 1078, 1081 (6th Cir.1989) (lump sum settlement to compensate employees for employer's failure to make tax-exempt contributions to employee insurance trusts is taxable); *Harte v. United States*, 252 F.2d 259, 261-62 (2d Cir.1958) (annuity payments received under an agreement settling a will contest constituted taxable income from the property of an estate, even though settlement released plaintiffs' claims on the property of the estate and a distribution of the property of the estate would have been excluded from plaintiffs' gross income); see also *Ocean Drilling & Exploration Co. v. United States*, 220 Ct.Cl. 395, 600 F.2d 1343, 1349 (Ct.Cl.1979) (tax status of an obligation is not altered by the fact that it can be "traced back" to a prior liability that would have been entitled to more favorable tax treatment).

I hope this is helpful. Let me know whether you still think it is necessary to discuss.